

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201125007**
Release Date: 6/24/2011
Index Number: 2055.12-10

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: , ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B04
PLR-134647-10
Date:
February 16, 2011

Date of Death:

Trust	=
Decedent	=
Date 1	=
Date 2	=
Niece	=
Foundation	=
Family Member	=
Date 3	=
<u>A</u>	=
Court	=
State	=
Date 4	=
Date 5	=
State Statute	=
Family Member	=
CRAT	
<u>B</u>	=
<u>C</u>	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
<u>D</u>	=
<u>E</u>	=

Dear _____ :

This letter responds to your authorized representative's submission dated August 20, 2010 requesting a ruling on the application of § 2055(e)(3) of the Internal Revenue Code to the judicial reformation of Trust.

FACTS

The facts and representations are as follows. Decedent created Trust as a revocable trust on Date 1. Trust became irrevocable on Date 2, the date of Decedent's death.

Article V of Trust provides that upon the death of Decedent, after the payment of Decedent's debts and expenses and the distribution of certain tangible personal property to Niece, the residuary assets of Trust shall be distributed to Foundation, subject to the provisions of Article I of Trust. Foundation is an organization described in § 501(c)(3).

Family Member is an elderly relative of Decedent, born on Date 3. Article I of Trust, in relevant part, provides for the trustee to pay for the health costs of Family Member for the duration of Family Member's life and the burial expenses upon Family Member's death. Article I further provides that at the time Trust was executed, Family Member resided in an assisted living facility and had monthly expenses of \$A. Article I anticipates that Family Member's expenses may increase and directs the trustee to provide any necessary funds and authorizes the invasion of principal.

Although Trust, as drafted, provides for a specified distribution to an individual for life followed by an irrevocable remainder interest to be paid over to charity, the noncharitable interest is not in the form of a sum certain or fixed percentage that is payable at least annually as is required for Trust to qualify as a charitable remainder annuity trust or charitable remainder unitrust under § 664. Additionally, Trust, as drafted, does not include certain administrative provisions required for Trust to qualify as a charitable remainder trust under § 664. Therefore, under the original Trust instrument, Foundation's remainder interest does not qualify for the estate tax deduction for charitable transfers allowed under § 2055(a).

The executor of Decedent's estate retained a valuation expert to determine the value of Family Member's interest by considering the foreseeable and ascertainable costs to fulfill the distribution standard under the original trust instrument. Using the information from the expert's report, the executor of Decedent's estate filed a petition in Court to reform Trust under State law in order to qualify Trust as a charitable remainder annuity trust under § 664(d)(1). The petition was filed on Date 4, before the estate's United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706) was timely filed. A guardian ad litem was appointed by Court to represent the interests of

Family Member. A hearing was held and on Date 5, Court issued “Order” determining, in relevant part, that (a) all interested and necessary parties were before the Court or, in the case of the attorney general of State, waived the right to be heard; (b) under State law, the distribution language relating to Family Member is an ascertainable distribution standard requiring distributions for Family Member’s health, support, and maintenance during Family Member’s lifetime; and (c) Court has the authority to modify Trust pursuant to State Statute and Court’s construction of Trust. Court ordered that Trust be reformed as requested and that such reformation shall be effective upon the date of Decedent’s death, contingent upon the issuance of a private letter ruling from the Internal Revenue Service (Service) holding that the reformation constitutes a qualified reformation under § 2055(e)(3).

Under Trust, as conditionally reformed pursuant to Court’s order, Article V of Trust provided that the residuary assets of Trust shall be distributed to Family Member CRAT, as created by Article XIII of Trust. Article XIII of Trust provided, in relevant part, as follows.

Paragraph 1 of Article XIII of Trust provides that Family Member CRAT is intended to qualify as a CRAT within the meaning of § 664(d)(1) and Rev. Proc. 2003-57, 2003-1 C.B. 257. To the extent any other provision of Trust is in conflict with Article XIII, the provisions of Article XIII control. After funding of Family Member CRAT, no trust assets shall be distributed from the trust for the payment of any estate or inheritance taxes.

Paragraph 2 of Article XIII of Trust provides that the annuity amount is equal to 5 percent of the initial net fair market value of all property passing to the trust. For the duration of the annuity period, the trustee shall pay B percent of the annuity amount to Family Member and C percent of the annuity amount to Foundation. The first day of the annuity period shall be the date of Decedent’s death and the last day of the annuity period shall be the date of Family Member’s death.

Paragraph 3 of Article XIII provides that although the obligation to pay the annuity amount commences with the date of Decedent’s death, the trustees may defer payment until the end of the taxable year in which the respective trust is completely funded.

Paragraph 4 of Article XIII provides that the trustee shall prorate the annuity amount on a daily basis for any short taxable year.

Paragraph 5 of Article XIII provides that at the termination of the annuity period, the trustee shall distribute all of the then principal and income of the trust (other than any annuity amount due Family Member or Family Member’s estate and Foundation) to Foundation. If Foundation is not an organization described in §§ 170(c) and 2055(a) at the time, then the trustee shall distribute the amount to one or more organizations

described in §§ 170(c) and 2055(a) as the trustee shall select in the trustee's sole discretion.

Paragraph 6 of Article XIII prohibits additional contributions after the initial contribution.

Paragraph 7 of Article XIII prohibits the trustees from engaging in any act of self-dealing, as defined in § 4941(d); making any taxable expenditures, as defined in § 4945(d); paying any amount other than the annuity amount for less than full and adequate consideration to or for the use of any person other than an organization described in §§ 170(b), 170(c), 2055(a), and 2522(a); retaining any excess business holdings as defined in § 4943(c); and making any investments that would subject a trust to tax under § 4944.

On Date 6, the executor of Decedent's estate submitted a request for a private letter ruling to the Service. The Service determined that the method used to value the non-charitable beneficiary's interest under the original trust instrument was not reasonable. After taking into consideration the Service's assessment, the estate's valuation expert determined a revised value for Family Member's interest under the original trust instrument. In the report, the valuation expert considered the reasonable and foreseeable costs of health, maintenance, and support using actual records of expenses, cost estimates provided by the local funeral home, publicly available interest rates, AARP studies of nursing home rate increases, and bank trustee representations of administrative costs.

Based on the revised valuation of the noncharitable interest, Decedent's estate filed "Plaintiff's Motion to Modify Order" on Date 7, seeking an adjustment to the percentage of the annuity amount payable to Family Member and a corresponding adjustment to the percentage of the annuity amount payable to Foundation. A second hearing was held on Date 8 and Court issued a "Second Amended Order" on Date 9, approving the estate's motion.

Under Trust, as conditionally reformed pursuant to Court's second amended order, all of the provisions of Family Member CRAT are identical to those included in the Trust reformed pursuant to Court's original order on Date 5; however, the percentages of the 5 percent annuity amount payable to Family Member and Foundation in paragraph 13.2 of Article XIII of Trust have been changed to D percent and E percent, respectively.

You have requested the following rulings:

1. The judicial reformation of Trust is a qualified reformation for purposes of § 2055(e)(3).

2. A deduction is allowable under § 2055(a) for the present value of the remainder interest in Family Member CRAT passing to Foundation.

LAW AND ANALYSIS

Section 2055(a) provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, and transfers to or for the use of any corporation or certain other organizations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Section 2055(e)(2) provides that where an interest in property passes or has passed from the decedent to a person, or for a use, described in § 2055(a), and an interest (other than an interest that is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in § 2055(a), no deduction is allowed under § 2055(a) for the interest that passes or has passed to the person, or for a use, described in § 2055(a), unless in the case of a remainder interest, the interest is in a charitable remainder annuity trust or a charitable remainder unitrust (described in § 664) or a pooled income fund (described in § 642(c)(5)). In the case of an interest other than a remainder interest, the interest must be in the form of a guaranteed annuity or a fixed percentage distributed annually of the net fair market value of the trust assets (determined annually).

Section 2055(e)(3)(A) provides that a deduction shall be allowed under § 2055(a) with respect to any qualified reformation.

Section 2055(e)(3)(B) provides that the term “qualified reformation” means a change of a governing instrument by reformation, amendment, construction, or otherwise that changes a reformable interest into a qualified interest, but only if—

- (i) any difference between (I) the actuarial value (determined as of the date of the decedent's death) of the qualified interest, and (II) the actuarial value (as so determined) of the reformable interest does not exceed 5 percent of the actuarial value (as so determined) of the reformable interest,
- (ii) in the case of (I) a charitable remainder interest, the nonremainder interest (before and after the qualified reformation) terminated at the same time, or, (II) any other interest, the reformable interest and the qualified interest are for the same period, and
- (iii) the change is effective as of the date of the decedent's death.

Section 2055(e)(3)(C)(i) provides that the term “reformable interest” means any interest for which a deduction would be allowable under § 2055(a) at the time of the decedent's death but for § 2055(e)(2).

Section 2055(e)(3)(C)(ii) provides, in part, that the term “reformable interest” does not include any interest unless, before the remainder vests in possession, all payments to persons other than an organization described in § 2055(a) are expressed either in specified dollar amounts or a fixed percentage of the fair market value of the property.

Section 2055(e)(3)(C)(iii) provides, in part, that § 2055(e)(3)(C)(ii) does not apply to any interest if a judicial proceeding is commenced to change the interest into a qualified interest not later than 90 days after the last date (including extensions) for filing an estate tax return, if an estate tax return is required to be filed.

Section 2055(e)(3)(D) provides that the term “qualified interest” means an interest for which a deduction is allowable under § 2055(a).

Section 2055(e)(3)(E) provides that the deduction referred to in § 2055(e)(3)(A) shall not exceed the amount of the deduction that would have been allowable for the reformable interest but for § 2055(e)(2).

In this case, the charitable remainder interest in Trust is a reformable interest under § 2055(e)(3)(C). As originally drafted, Trust provided for a charitable remainder interest that was presently ascertainable and severable from the noncharitable interest. See § 20.2055-2(a) of the Estate Tax Regulations. Accordingly, the remainder interest passing to Foundation would have qualified for an estate tax charitable deduction under § 2055(a), but for the requirements of §§ 2055(e)(2) and 664. In addition, the reformation proceeding was commenced within the time prescribed in § 2055(e)(3)(C)(iii), so the requirement in § 2055(e)(3)(C)(ii) does not apply to exclude Foundation's interest as a reformable interest.

Further, the reformation satisfies the requirements for a qualified reformation under § 2055(e)(3)(B). The actuarial value of the charitable remainder interest in Family Member CRAT will not differ by more than 5 percent from the actuarial value of those interests provided for prior to reformation, determined under § 7520, using reasonable valuation assumptions. In addition, under the terms of Family Member CRAT, Family Member's interest will terminate at the same time as it would have terminated under the terms of the original trust instrument. Finally, the reformation will be effective as of the date of Decedent's death.

Accordingly, based on the information submitted and representations made, we conclude that the reformation of Trust, as described above, constitutes a qualified reformation within the meaning of § 2055(e)(3), provided the reformation is effective

under State law. We further conclude that an estate tax charitable deduction is allowable under § 2055(a) for the present value of the charitable remainder interest, as determined under § 20.2055-2(f)(2)(i), provided Family Member CRAT qualifies as a charitable remainder annuity trust described in § 664(d)(1). The amount of the deduction is subject to the limitation in § 2055(e)(3)(E), if applicable.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Leslie H. Finlow
Senior Technician Reviewer, Branch 4
Office of Chief Counsel
(Passthroughs & Special Industries)

Enclosure (1)